BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I. Opinions of the Court Below.

The opinion of the Board of Tax Appeals is reported in 42 B. T. A. 402. It appears in the Record filed in the court below at page 67.

The opinion of the Circuit Court of Appeals for the 3d Circuit is not yet reported. It appears in the Record at page 86.

II. Jurisdiction.

The opinion of the Circuit Court of Appeals was filed May 29, 1941. The statute under which jurisdiction is invoked is section 240 (a) of the Judicial Code (28 U. S. C., section 347), as amended by the Act of February 13, 1925, 43 Stat. 938.

III. Statement of the Case.

A full statement of the case is presented under the heading "Summary Statement of Matter Involved" in the petition and, in the interest of brevity, is not repeated at this point. The basic question involved may be summarized as follows:

> Petitioner created four separate, irrevocable trusts, one for each of his four minor children. He reserved none of the income or corpus for his individual use and provided that the income from each trust be paid to him during the minority of each child as, if and when ordered by him in writing that it be paid to him, and if so paid, to be used solely for the support, maintenance, education and enjoyment of said minor. None

of the income was paid to him and used for such purpose or to meet any legal obligation of the petitioner. All of the income, with the exception of a small amount, remained in the trust and was reinvested and became a part of the corpus. Is the income from the trusts taxable to the petitioner?

IV. Specification of Error.

The court below erred in holding as taxable to the petitioner, income from securities which he had irrevocably given to a trustee in trust for his minor children, all of which was accumulated for the benefit of the children and none of which was in fact used for the maintenance, education or support of the children.

V. Argument.

None of the income of the four trusts for petitioner's minor children is taxable to him, because none of the income was used for the maintenance, education or support of the children.

The income totaled $5,878.00. All except $450.00 remained in the trusts, was reinvested and became a part of the corpus. The $450.00 was paid to the grantor and used by him to purchase certain shares of stock which were issued to and registered in the names of the children. No part of the income was used by the grantor in discharge of any legal obligation of the grantor. The Board of Tax Appeals (six members dissenting) held the income taxable to the grantor. The Circuit Court affirmed.

The trust is, of course, valid *as a trust*. If, in spite of its provisions, income realized and used by the trustee in accordance with its terms must nevertheless be taxed to the grantor of the trust, the authority to do so must be found

in the Revenue Act. We believe it cannot be denied that the Commissioner must rely either upon Section 22, which is the section dealing with gross income generally, or Section 167, which taxes income from trusts to the grantor under certain circumstances (26 U. S. C. A. § 22, 166 and 167).

We shall, therefore, consider Section 22 and Section 167. Section 22 in broad, general language provides for the taxation of income from whatever source it is derived. Under this section, as interpreted by this Court, it is clear that even the cases that have gone furthest in reaching income on the legal obligation theory, have taxed only income which has been actually paid and used to discharge a legal obligation of the taxpayer: *Douglas v. Willcuts,* 296 U. S. 1 (1935). It is clear from this case and all others decided under this section, that amounts paid in discharge of a legal obligation of the taxpayer are to be treated as income of the taxpayer. The basis of these decisions, as set forth in *Douglas v. Willcuts,* 296 U. S. 1, 9, is that, "The transaction is regarded as being the same in substance as if the money had been paid to the taxpayer and he had transmitted it to his creditor." Not only are the facts of these cases not similar to the facts of the instant case, because the money in this case was not used to discharge a legal obligation of the petitioner, but the basis of those decisions is clearly inapplicable to facts such as those in the case at bar. It must also be noted that the Court in *Douglas v. Willcuts* distinguishes the trust provisions of the Revenue Acts from Section 22 and makes it clear that they are set up to cover different types of situations. Neither section is a limitation or addition to the other, and each must stand on its own footing. We submit no case can be found where income has been held taxable to a taxpayer under Section 22 unless he was legally the owner

of the income or it was used to discharge his own legal obligation. That is not the case before this Court.

The Court below, however, felt that *Helvering v. Horst*, 311 U. S. 112 (1940), was an authority for assessing the tax against settlor under Section 22. In that case, the owner of negotiable bonds detached the interest coupons and delivered them to his son as a gift prior to their due date. The son collected them on the due date. The court held that the interest payments collected by the son were taxable income to the donor. We cannot see the possible relevancy of the *Horst* case to the facts in the case presented here. Obviously, if the donor in the *Horst* case had made a clear gift of the bonds themselves with the coupons attached, the result would have been different. Otherwise, it would no longer be possible to make a simple gift. Here, the gift is complete.

Yet the court below seizes upon certain language of Mr. Justice Stone in the *Horst* case, quotes it, finds it "most conclusive" of the question in this case, and pronounces the amazing doctrine that the income in this case is taxable to the grantor because of the "non-material satisfaction" which the grantor must have experienced in creating such a trust for his children. We find no fault with the quoted language when considered in connection with the facts involved in the *Horst* case, but the court below has taken the language in the abstract without relation to any particular set of facts and in effect holds that the Supreme Court of the United States has held that where a taxpayer makes a gift of securities and obtains some mental satisfaction out of making the gift, the income from the securities is taxable to him. We believe that this Court never intended to pronounce any such principle and that it has no more impor-

tant task to perform than to correct a Circuit Court which feels otherwise.

The opinion of the court below also refers to other powers which the grantor had in connection with the trusts. However, we believe it is clear that these powers are not such as will make the income from the trusts taxable to the grantor under the doctrine of *Helvering v. Clifford*, 309 U. S. 331 (1940). Essential elements in the *Clifford* case were the short term of the trust and the fact that the trust corpus reverted to the settlor at the end of the short term. The importance of these elements is clearly set forth in the Supreme Court's Opinion, on page 334:

> "We granted certiorari because of the importance to the revenue of the use of such short term trusts in the reduction of surtaxes."

The trusts in the instant case could not revert to the donor and each trust is to continue until the children of the grantor descending from the named child of the grantor become twenty-one years of age. During the years here in issue, the four children of the grantor were all minors, so that it obviously would be a considerable period of time before all the children of these minors would become twenty-one years old.

We now come to the relevancy of Section 167, which the court below merely stated was a question involved but did not decide because of its view of the *Horst* case. Our argument is, consequently, largely an attack upon the opinion of the Board in this respect. Under 167 (a), (2), if the trust income "may in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income, be distributed to the grantor," this part of the income of the trust will be

taxable to the grantor. The case of *Helvering v. Wood*, 309 U. S. 344 (1940), points out that the range of inquiry under Section 167 or like sections of the Revenue Acts is narrowly confined. The language is not broad and general, it is specific and clear. Do the facts of this case come within the language of Section 167? Obviously not, because "distributed to the grantor" as used in the statute clearly means distributed to him for his own use, and under no circumstances could the grantor avail himself of these funds for any personal use he chose.

Nothing would seem to be better settled than that income of a trust which may, in the discretion of the Trustee, be distributed for the maintenance and support of minor children of the grantor, *but which is in fact not so distributed*, is not taxable to the grantor. Even General Counsel Memorandum 18972, which was promulgated in 1937, so holds. This is the published opinion of the Chief Counsel for the Bureau of Internal Revenue. So far as we know, it is still in force. We can't understand why Respondent should publish one rule for the guidance of taxpayers and adopt another when it appears the taxpayer has done exactly as the ruling declared he should have done. This opinion is published in 1937-2 Cumulative Bulletin, p. 231, and reads in part (p. 233):

> "This office has reached the conclusion that in cases where the trust income, or at least part of it, might, in the discretion of the trustees, have been used to support the minor children of the grantor there should be taxed to the grantor only so much of the trust income as is actually distributed for the support and maintenance of the beneficiaries whom the grantor is legally obligated to support. The fact that the trust income may be distributed for the support of such per-

sons (but actually is not) does not make such income subject to distribution to the grantor within the meaning of section 167 of the Revenue Acts here involved.

"The opinion in *E. E. Black v. Commissioner*, promulgated by the Board of Tax Appeals on July 20, 1937 (36 B. T. A. 346), correctly states the rule."

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"Consequently, it is held that none of the income of the trusts in the instant case is taxable to the grantor under section 167 of the Revenue Acts of 1932 and 1934, since no part of the income was distributed or used for the support and maintenance of the beneficiaries."

As the dissenting opinion of the Board points out, all of the decisions except the anomalous case of *J. S. Pyeatt v. Commissioner*, 39 B. T. A. 774, are in accord with that ruling. Some of the authorities are:

Higgins v. White, 93 Fed. (2d) 357, (C. C. A. 1st, 1937), reversed on other grounds 116 F. (2d) 312 (1940);

Black v. Commissioner, 36 B. T. A. 346 (1937);

Berolzheimer v. Commissioner, 40 B. T. A. 645 (1939), reversed on other grounds 116 F. (2d) 628 (1940);

Hudson v. Jones, 22 Fed. Supp. 938 (1938);

Tiernan v. Commissioner, 37 B. T. A. 1048 (Appeal to C. C. A. 3d dismissed without opinion June 12, 1939);

Wolcott v. Commissioner, 42 B. T. A. 1151 (1940);

Chandler v. Commissioner, 41 B. T. A. 165, affirmed as to other issues 119 F. (2d) 623 (1941).

The opinion of the Board of Tax Appeals in the *Tiernan case,* 37 B. T. A. 1048, at page 1054, is particularly appropriate because of the similarity of its facts to the case at bar:

> "1. Although the four trusts established by Tiernan and by Wallace were for the benefit of their children in one case and of their children and wives in another, there was no power of revocation and no provision whereby under any circumstances either the corpus or the income could be revested in the grantor, hence there is no foundation for the application of section 166 or 167, Revenue Act of 1932. There is in each trust instrument a provision under which the trustee may in his discretion use the income for the education and support of the grantor's child, but it appears that in fact no such use was made of the income and that in fact the grantor was not relieved of any parental duty or obligation to maintain a child. The income was in fact accumulated and invested by the trustee. The wives in the taxable years in question actually received nothing from the trustees either by way of maintenance or otherwise. Thus the circumstances in evidence take the case entirely outside the scope of *Douglas v. Willcuts,* 296 U. S. 1, and similar cases, and bring it within *E. E. Black,* 36 B. T. A. 346, holding that the income of the trust is not under such circumstances taxable to the grantor."

It is equally well settled that a trustee, as such, does not have an adverse interest in the trust: *Reinecke v. Smith,* 289 U. S. 172 (1933).

There is no sound basis for failing to apply this rule to a factual situation such as that here presented, where the discretion is in the grantor instead of in some other person who does not have an adverse interest. A reading of

Section 167 (a), (2) would seem to dispose of this question. The Act specifically provides that where any part of the income "may, in the *discretion of the grantor* or of *any person not having a substantial adverse interest* in the disposition of such part of the income, be distributed to the grantor . . . then such part of the income of the trust shall be included in computing the net income of the grantor." (Italics supplied.) This section specifically states that income which may be "distributed to the grantor" in his discretion is given the same legal effect as income which may be distributed to him in the discretion of any other persons who do not have an adverse interest in the income. Both situations are clearly set forth as alternatives and have the same result for tax purposes. Here, no part of the income could be distributed to grantor, except for the support of his minor children. In some of the cases cited above, the settlor was also trustee, and therefore exercised his discretion in determining whether or not payments were to be made for the maintenance of his minor children, but this did not render the undistributed income taxable to the settlor. *Higgins v. White*, 93 Fed. (2d) 357 (1937); *Tiernan v. Commissioner*, 37 B. T. A. 1048 (1938); *Berolzheimer v. Commissioner*, 40 B. T. A. 645 (1939). We believe that the error of the Board of Tax Appeals in this case is caused by adding the provisions of Section 22 to those of Section 167, or vice versa. As the dissenting opinion of the Board clearly states:

> "That result [the holding of the majority] requires a linkage of the rationale of Douglas v. Willcuts, 296 U. S. 1, with the language of the cited section [167 (a), (2)], which, I think, is unjustifiable and barred by that section itself."

We believe that the opinions of this court demonstrate convincingly that the trust provisions and Section 22 are separate, distinct and independent bases of taxation. Their effect is not cumulative, complementary, coextensive, coterminus, or to limit each other. If the facts of any case come within either section 22 on the one hand, or section 167 on the other hand, the tax may be imposed—but for the tax to be imposed, the facts must come within one of these sections. When we apply this test to the facts of the instant case, we believe that it is clear that the income from these trusts cannot be taxed to the donor under the provisions of either section. The conclusion of the dissenting opinion of the Board is inescapable that, "the only possible basis, constitutionally and otherwise, for taxing the contested trust income to the grantor here, is under section 167 (a) (2) on the ground, implicitly barred by that section itself and inconsistent with decided cases, that he could have secured and used it to meet his legal obligation."

Conclusion.

The inclusion by the Respondent of the entire $5,878.00 of income from the four trusts in petitioner's individual income is without warrant in law. The agreed and stipulated facts, the decisions referred to above and in the dissenting opinion of the Board, and G. C. M. 18972 all support our contention. The trusts were valid and bona fide arrangements, irrevocably created under the laws of the Commonwealth of Pennsylvania. The income taxed to petitioner was not received by him, was not used by him in discharge of any legal obligation, and is therefore not chargeable to him. The contrary conclusion reached by the court below is based upon a principle of law so untenable that it should be

corrected, particularly because this Court is alleged to be the author of the principle.

Respectfully submitted,

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